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A Misunderstood Transaction

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THE CHICAGO & ALTON CASE

A MISUNDERSTOOD TRANSACTION

The Chicago & Alton Case

A Misunderstood Transaction

By George Kennan

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THE CHICAGO & ALTON CASE

A MISUNDERSTOOD TRANSACTION

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The Chicago and Alton Case: A Misunderstood Transaction

No episode, perhaps, in the career of the late E. H. Harriman has been more severely criticised by the Interstate Commerce Commission, by certain members of Congress, and by an ill-informed part of the public than the reorganization of the Chicago & Alton Railroad in 1899 and 1900. It excited little comment at the time, but when, long afterward, the Government began its campaign against Mr. Harriman, through the Interstate Commerce Commission, the transaction was characterized as "indefensible financing," and was described as the "crippling," "looting," and "scuttling" of a well-managed and prosperous railroad by a syndicate of unscrupulous financiers in which Mr. Harriman was the "main conspirator."[1]

The Chicago & Alton Railroad, when Mr. Harriman became connected with it, was an

[1]Reports of the Interstate Commerce Commission, Vol. XII, pp. 301-303; statement of Senator Cullom, New York *Independent*, Vol. LXII, p. 692; "Railroads: Finance and Organization," by Prof. W. Z. Ripley, pp. 262-267. N. Y., 1915.

apparently prosperous and well-managed road. It had paid dividends of 8 per cent. on its invested capital for thirty years or more; its credit was good, and its shares of common and preferred stock were selling at from 75 to 100 points above their par value. From a financial point of view, it seemed to be as strong as any railroad of its class in the Middle West. Unfortunately, however, its managers had pursued an ultra-conservative policy in the matter of expenditures, and had neglected, for a long time, to make necessary appropriations to cover depreciation, and to provide for extensions, betterments, replacements, and additional equipment. The road had grown old without improving in physical condition; and had become more or less incapable of rendering the service demanded by a rapidly growing and developing territory. Speaking of this state of affairs, the well-known economist, Prof. E. S. Mead, says:

"The condition of the Alton was far below that of its competitors. The standards of construction were those of fifteen years before. The track was laid with steel rails, but these were only seventy pounds to the yard. The bridges were in good condition, but were too light for heavy engines. The capacity of the

sidings and second track was inadequate to handle large increase of traffic. In short, the company had not maintained a sufficient depreciation account, and its property had not been kept up to standard."[1]

According to J. H. McClement, expert accountant, who had occasion to investigate the affairs of the company:

"It had not added one mile of road in seventeen years. It had little or no reserve capacity to conduct a larger business. Its cost of operation, per unit of traffic, was very high in comparison with similar roads. Its grades were uneconomical. Its shops and equipment were uneconomical and old. Its settled policy against the expansion of its facilities, because of declining rates, was an absolute bar to the development of the tributary country. While for twenty-five years it had paid an average dividend of 8.3 per cent. on its capital stock, the gross earnings for the year 1898"—(the year before Mr. Harriman became interested in it)—"amounting to $6,286,000, were the lowest since 1880, and had been gradually falling since 1887, when they amounted to $8,941,000. In many respects the company was being conducted like a commercial enterprise having in

[1] "Corporation Finance," by Edward Sherwood Mead, Ph. D., Wharton School of Finance and Commerce, University of Pennsylvania, pp. 252-253. N. Y., 1914.

view ultimate liquidation, instead of like a public carrier."[1]

The ultra-conservative—not to say parsimonious—policy of the management, the progressive deterioration in the physical condition of the road, and the decline of $2,655,000 in annual earnings in a period of eleven years, naturally created dissatisfaction and excited a feeling of uneasiness among the owners of the company's securities; and in the fall of 1898 a number of the large stockholders, actuated by a feeling of apprehension as to the future of the road, requested John J. Mitchell, President of the Illinois Trust Company, to open negotiations with Mr. Harriman, with a view to the sale of the property and a financial reorganization of the company.[2]

Mr. Mitchell had an interview with Mr. Harriman in New York, and represented to

[1]"Statement of the Recapitalization of the Chicago & Alton Railroad Company," by J. H. McClement, Expert Accountant. N. Y., 1907.

[2]Among the prominent stockholders of the Chicago & Alton at this time were Morris K. Jessup of New York, Marshall Field of Chicago, John A. Stewart of New York (President of the U. S. Trust Company and formerly Assistant Treasurer of the United States), Albert A. Sprague (of Sprague Warner & Co., Chicago), A. C. Bartlett (Vice-President of Hibbard, Spencer, Bartlett & Co., Chicago), and John J. Mitchell (President of the Illinois Trust Company). These were not men likely to be hoodwinked or deceived by "unscrupulous financiers" bent on wrecking the Alton road.

him that "many of the Alton stockholders were dissatisfied with the existing management; that the stock might be bought for less than the real value of the property; that if betterments and improvements were made and modern methods introduced the earnings might be largely increased, and that if control of the road were purchased, if funds for such betterments were provided, and if the road were developed, there would be an opportunity for a substantial profit."

Mr. Harriman, who had never before thought of purchasing the Chicago & Alton, told Mr. Mitchell that he would take the matter into consideration, and ascertain as soon as possible the condition of the road. Shortly after this interview Mr. Harriman requested Mr. S. M. Felton, a well-known expert and railroad manager,[1] to make a thorough examination of the property and submit a detailed report on its condition, requirements, and earning capacity. Mr. Felton's report was favorable. He estimated that better management, and the ex-

[1]Mr. Felton had had long and varied railroad experience as Chief Engineer of the Chester & Delaware River Railroad; General Superintendent of the P. C. & St. L.; General Manager of the N. Y. & N. E.; Vice-President of the Erie, of the East Tenn., Va. & Ga. system, of the Memphis & Charleston, and of the Mobile & Birmingham; and President of the Alabama Great Southern, and of the N. O. & Texas Pacific.

penditure of $5,200,000 for improvements and additional equipment would enable the road to increase its earnings by at least $1,000,000 a year on the traffic then existing, to say nothing of the increased traffic that might be expected when the road should be able to afford adequate facilities to the then rapidly developing territory that it served.

Becoming satisfied that the road could be bought for less than its potential value, Mr. Harriman invited Jacob H. Schiff (of Kuhn Loeb & Co.), James Stillman (President of the National City Bank), and George Gould to join him in making the purchase on the terms suggested, and in providing the necessary funds for betterments and additional equipment, as well as for the refunding or retirement of the company's maturing bonds. Upon the representations made by Mr. Harriman, Messrs. Schiff, Stillman, and Gould agreed to coöperate with him, and the four men formed a syndicate for the purchase, reorganization, and recapitalization of the Chicago & Alton road.

This syndicate was ultimately made to include Morris K. Jessup, John A. Stewart (ex-Assistant Treasurer of the United States), John J. Mitchell (President of the Illinois Trust Company), and other individuals of like character, as well as

some of the leading financial houses and institutions of the country. The supposition that men and firms of such standing would join a band of "pirates" and "looters" for the purpose of "wrecking" and "gutting" the Alton is, to say the least, highly improbable. The public assumed, or was led to believe, that Messrs. Harriman, Stillman, Schiff, and Gould were the sole managers and beneficiaries of the reorganization; but this was not the case. The four gentlemen named organized the syndicate, but it included about one hundred members.

In January, 1899, the syndicate purchased 97 per cent. of the capital stock of the Chicago & Alton Company (about 218,000 shares) and paid therefor the sum of $38,815,000 in cash. They then proceeded to readjust the accounts of the company by crediting to surplus the sum of $12,444,000, which the old managers of the road, in previous years, had taken out of current income and invested in permanent betterments. In the opinion of the new owners and their legal counsel, permanent improvements and additions to the property ought to have been charged to capital account, and not taken out of surplus earnings, which belonged to the stockholders and might properly have been distributed in dividends. The newly

elected directors, therefore, charged to capital the sum of $12,444,000 previously spent in betterments, and credited it to surplus, with a view to distributing a part of it ($6,669,000) in the shape of a 30 per cent. dividend on the old stock, and so lessening the cost of the road to its purchasers.

Having thus acquired the property, and transferred the cost of previous betterments to capital account, the syndicate, which included 97 per cent. of the stockholders, reorganized the corporation and elected as President Mr. S. M. Felton, upon whose report the road had been bought. They then recapitalized the company by issuing securities in the following amounts:

50-year 3 per cent. bonds	$31,988,000[1]
50-year 3½ per cent. bonds	22,000,000
4 per cent. preferred stock	19,544,000
Common stock	19,542,000
Total	$93,074,000

The $31,988,000 of 3 per cent. bonds actually issued were offered to all the stockholders and

[1]Forty millions in 3 per cent. bonds were authorized, but $8,012,000 were held in reserve for future requirements. These eight millions were subsequently sold at market rates, and the proceeds were spent on the property.

taken by them pro rata, at 65, which was believed at the time and in the circumstances to be a fair rate. The purchase of these securities at a cost of $20,792,200, and the acquirement of 97 per cent. of the stock of the old company at a cost of $38,815,000, made the investment of the syndicate in the reorganized road $59,607,200. This sum was soon afterward increased by the purchase of the Peoria Northern Line at $3,000,000, and the payment of $500,000 for commissions, charges, legal expenses, etc., in connection with the reorganization. This made the total investment of the new owners of the road $63,107,200, as shown below:

Purchase of 97 per cent. of the old company's stock	$38,815,000
Purchase of $31,988,000 3 per cent. bonds at 65	20,792,200
Purchase of Peoria Northern Line .	3,000,000
Commissions, legal expenses, etc. . .	500,000
Total	$63,107,200[1]

As soon as the sale of the bonds put sufficient money into the treasury and made available

[1]It is quite possible that the syndicate did not have this whole amount invested at any one time, because some of the securities may have been sold before the transaction was completed. The figures are given in this way only for the purpose of showing how much money the stockholders put into the venture from first to last.

the $12,444,000 of surplus created by capitalizing the sums previously spent in betterments, the new directors declared a cash dividend of 30 per cent. on the old company's stock, for the purpose of lessening the cost of the road to its buyers. This reduced the sum of their investment as follows:

Total cost of the road to its purchasers (as shown above)	$63,107,200
Less dividend of 30 per cent. on the old stock	6,669,180
Reduced cost	$56,438,020

To represent this investment, the new stockholders had in hand, for sale at the best prices they could get:

3 per cent. bonds, par value . . .	$31,988,000
3½ per cent. bonds, par value . . .	22,000,000
4 per cent. preferred stock, par value.	19,544,000
Common stock par value . . .	19,542,000
Total	$93,074,000[1]

In order to get back the amount that they had actually put into the property ($56,438,020 as above shown) the stockholders would have to

[1]This capitalization was increased to $101,086,000 when the reserved bonds ($8,012,000) were issued. The total of 3 per cent. bonds was then $40,000,000 instead of $31,988,000, as here stated.

sell the bonds and preferred stock at approximately the following figures:

$31,988,000 3 per cent. bonds at 80 .	$25,590,400
22,000,000 3½ per cent. bonds at 74 .	16,280,000
19,544,000 preferred stock at 75 .	14,658,000
Total	$56,528,400
Money invested	56,438,020

They would then have the common stock as clear profit, and if they sold it at, say, 25, they would make about $5,000,000 on the purchase and recapitalization of the road. This would be equivalent to about 9 per cent. on their total investment. They perhaps made more than this, but how much more it is impossible to determine. After the securities were distributed among the members of the syndicate they were sold by the individual owners at various prices, and at various times between 1900 and 1907. The profit realized depended, in every case, upon market conditions at the date of sale. Professor Ripley states, as a fact, that the profits of the syndicate—that is, of the one hundred or more stockholders—were $23,600,000; but as he does not give his method of computation there is no possibility of testing his results. The Attorney-General

of Illinois figured that the syndicate made a profit of $24,648,600; but his calculations were soon discredited. Expert Accountant J. H. McClement showed that even accepting the inordinately high prices at which the Attorney-General assumed the stockholders sold, their profit was only $11,124,300. In other words, the figuring did not work out.[1]

As a matter of fact, the computations of both Ripley and the Attorney-General were mere guesses, made under the influence of a strong anti-Harriman bias. If the stockholders sold their securities at the average prices that prevailed between 1901 and 1907, they made $7,624,000. If they sold in the summer of 1903, when the control of the road was acquired by the Rock Island, they made $2,800,000. If they held on until 1907, and sold then, they lost $1,400,000.[2] The probability is that most of the stockholders sold at the most favorable time—i. e., in the first year, or the first two years, after the securities were distributed. By an Act of the New York Legislature, approved February 26, 1900, the 3 per cent. bonds of the Alton road were made a

[1] "Statement of the Recapitalization of the Chicago & Alton Railroad Company," pp. 13-14. N. Y., 1907.

[2] McClement: pp. 13-14 et seq.

legal investment for the savings banks of that state, and this immediately created a good demand for them at prices which ranged from 82½ to 94. As there is no means, however, of ascertaining when the hundred or more stockholders disposed of their holdings, nor what prices they obtained for them, it is impossible to know what their profits were; and for that reason all estimates are more or less conjectural. The most that can be said with certainty is that owing to favorable market conditions, those who happened to sell at top prices realized more than they had anticipated.

A prominent New York banking house which had no connection with the Chicago & Alton transaction, except that it participated to the extent of $250,000 in the investment, was asked recently to look up its records and find out what its profits were. The value of its participation, and of the securities represented thereby, varied from time to time according to the market value of the securities. There were times when the transaction showed little or no profit. The maximum profit that it showed at any one time was about 8.2 per cent. The impression of these bankers is that if a participant got out at the most favorable time, he made a profit of about 9 per cent. The result of the reorganization,

so far as the stockholders are concerned, may be summarized in the statement that they invested $56,000,000 or $57,000,000 in the property (including the purchase of the 3 per cent. bonds), expanded the capitalization by issuing new securities to the par value of $93,074,000 (excluding the $8,012,000 held in reserve for betterments), and finally sold these securities at prices which gave them a net profit of probably 8 per cent., and possibly 12 or 15 per cent., upon their total cash investment.

At the time when the road changed ownership, the series of transactions above outlined excited little if any adverse criticism. Every detail of the reorganization, including the 30 per cent. dividend and the sale of the 3 per cent. bonds to the new stockholders at 65, had the widest possible publicity; but nobody complained of injury or injustice. The former owners of the road were satisfied with the price that they received; the 3 per cent. of the old stockholders who declined to sell their shares enjoyed precisely the same rights and privileges that were given to the new stockholders; the purchasers of the new securities bought with full knowledge of the syndicate's operations, and did not complain that they had been either misinformed or misled; the governors of the New

York Stock Exchange considered all the details of the recapitalization and then listed the new securities without objection or question; and, finally, the patrons of the road—the farmers, manufacturers, and shippers—were more than satisfied with the lower rates and greatly increased facilities that they enjoyed under the new management.

Serious and hostile criticism of the Chicago & Alton reorganization did not begin until 1906—seven years after the Harriman syndicate bought the road. In the fall of that year the friendly relations that had previously existed between President Roosevelt and Mr. Harriman were broken off, as the result of a disagreement, or misunderstanding, with regard to a contribution made by Mr. Harriman to the Republican campaign fund just prior to the Presidential election of 1904. Mr. Harriman thought that the President had failed to observe the terms of a mutual understanding with reference to the best means of promoting the interests of the party in New York; and when, in the fall of 1906, he was asked by James S. Sherman, Chairman of the Republican Congressional Committee, to contribute again, he declined to do so, for the alleged reason that the President had not kept faith with him. His refusal

was made known, of course, to Mr. Roosevelt—perhaps with an unfair or inaccurate statement of the reasons for it—and the President, resenting the imputation of unfaithfulness, assumed toward Mr. Harriman an attitude of hostility, and finally characterized him, in a letter to Representative Sherman, as an "undesirable citizen."[1]

Five or six months later—in April, 1907—a discharged stenographer, who had formerly been employed by Mr. Harriman, dishonorably sold to the New York *World* an imperfect copy of a private letter written by Mr. Harriman to one Sidney Webster of New York. In this letter Mr. Harriman set forth his understanding of the campaign-contribution episode, together with his reasons for believing that the President had treated him unfairly. The publication of this letter led to a somewhat acrimonious newspaper controversy, in which the President denied and Mr. Harriman reaffirmed the accuracy of the statements made therein.[2]

It may be only a chronological coincidence, but it was in November, 1906, immediately after the rupture of friendly relations between

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[1]Letter of President Roosevelt to James S. Sherman, dated October 8, 1906.

[2]New York *World* of April, 2, 1907, and subsequent dates.

the President and Mr. Harriman, that the Interstate Commerce Commission, acting either on its own initiative or upon suggestion, began its investigation of the "undesirable citizen's" past activities; and it was on the 5th of April, 1907, three days after the publication of the Webster letter, that the completed case was submitted to the Commission for decision.[1] The investigation covered of course the Chicago & Alton case, and the report thereon described the reorganization as "indefensible financing." The features of the transaction most severely criticised were the dividend of 30 per cent. on the stock of the old company, the selling of the 3 per cent. bonds to the new stockholders at 65, and the alleged "watering" of the original stock by increasing the number of shares without adding to the physical assets of the road a sum equal to the increase of capitalization. It will be most convenient, perhaps, to take up these transactions in the order in which they have been mentioned.

1. *The 30 per cent. dividend.*

That the new stockholders had a legal right to charge to capital the cost of permanent

[1] "Combinations and Consolidations of Carriers." Investigation begun November 15, 1906; case submitted April 5, 1907; case decided July 11, 1907. Reports of the Commission, Vol. XII, p. 277. Washington, 1908.

betterments which had previously been charged to income is unquestionable. The practice had not only the approval of expert accountants, but the sanction of the courts. In a precisely similar case in England the High Court of Appeal said:

"The circumstance that they had been paying what ought to be charged to capital out of revenue does not prevent their right, or their duty to the persons who are looking for their payment out of revenue, to credit back to revenue those things which have been carried, for the time being, to capital account."[1]

The new stockholders also had a legal right to transform the book surplus thus obtained into an actual cash surplus, by selling bonds to the necessary amount, and then to declare a cash dividend from the surplus so obtained. W. W. Cook, the standard authority on corporation law, says:

"When the company has used profits for improvements, it may lawfully borrow an equivalent sum of money for the purpose of a dividend. And it may properly borrow money for a dividend, if upon a fair estimate of its assets and liabilities it has assets in excess of

[1]Mills vs. Northern Railway & Co. 5 Chancery Appeals 621.

its liabilities, and capital stock equal to the amount of the proposed dividend."[1]

In paying a dividend of 30 per cent. out of a surplus created by capitalizing the cost of previous betterments, the new management was only doing what the old management had intended to do. In a circular letter to the old stockholders, written in February, 1899, T. B. Blackstone, then President of the Chicago & Alton Railroad, said:

"In case a majority of the shares of the company are not sold to the syndicate, I shall advise that you authorize the refunding of the outstanding bonds of the company, and the issue of a stock dividend to represent earnings heretofore invested in permanent improvements."

His reasons for making this recommendation were not only that large sums had previously been expended in permanent improvements, which ought to have been charged to capital, but that, as a result of this policy, the existing capitalization (bonds and stock together) represented less than 60 per cent. of the actual cost of the property.[2]

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[1]Cook on "Corporations," 5th edition, section 546.

[2]Report of President Blackstone for 1894.

Inasmuch as this undistributed surplus from past earnings was mainly responsible for the high price that the purchasers had to pay for the old stock ($175 and $200 per share) they naturally thought that they were justified in taking out of such surplus a part of the purchase money. That it belonged to them there can be no question. W. M. Ackworth, the leading European authority on railway administration, says, in a recent review of William E. Hooper's "Railway Accounting":

"Here in England no one has yet doubted that undivided profits, put back into the business, belong to the shareholders just as much as the property purchased with the capital originally subscribed."[1]

Halford Erickson, a member of the Railroad Commission of Wisconsin, an authority not likely to have a pro-railroad bias, seems to think that it might be expedient even to capitalize past losses and discounts.[2] Under recent rulings, moreover, of the Interstate Commerce Commission, permanent betterments must be charged to capital account, or at least kept

[1] *Railway Age Gazette*, August 23, 1915.

[2] "Government Regulation of Security Issues of Public Utility Corporations," p. 54. Madison, Wis., January, 1909.

separate from maintenance expenses in the books.[1]

In view of these considerations, it is hard to see why it was not proper, as it unquestionably was legal, to charge past betterments to capital account and declare a dividend of 30 per cent. on the old stock for the purpose of lessening the cost of the road to its buyers. The only reasonable objections to such a course are stated, very fairly, by Professor Mead and President Fink. The former is of opinion that capitalization of sums previously spent for betterments is justifiable only when the betterments have actually increased earnings, which in the Chicago & Alton case they had not done. "Its earnings for many years," Professor Mead says, "had been stationary," and "its property had not been kept up to standard." If the company had maintained a proper depreciation account, there would have been no such surplus. For these reasons he disapproves of the capitalization of past betterments and the issue of bonds to pay a dividend thereon; but he admits that, in the absence of state legislation expressly forbidding it, "the legality of the pro-

[1]W. M. Ackworth, in *Railway Age Gazette*, July 23, 1915. The subject is also discussed by Beale and Wyman in their "Railroad Rate Regulation," Sec. 355-362.

ceeding is not to be questioned."[1] This judgment, however, does not change the facts that the money *was* expended, the betterments *were* made, and the cost might properly have been charged, at the time, to capital account. The proceeding involves a question of financial expediency, but not, in any sense, of illegality.

President Fink objects to the capitalization of the cost of past betterments for the reason that it may afford an opportunity for manipulation of accounts.[2] In the Chicago & Alton case, however, no one ever asserted that the accounts had been tampered with, or that the sum of $12,444,000 had not actually been spent for permanent betterments. Both the old management and the new recognized the past expenditures for improvement as real and legitimate.

2. *The issue of* $31,988,000 *of* 3 *per cent. bonds to the new stockholders at* 65.

It was perfectly proper, and in accordance with general practice, to offer the new bonds to the stockholders before offering them to the public. The stockholders had taken the risk of putting $38,815,000 into the property, and it was only just that they should have the

[1] "Corporation Finance," pp. 246-253.

[2] "Federal Regulation of Railroad Securities," pp. 4-5.

first chance to buy the securities issued by the company upon reorganization. "But," it may be said, "the price at which the bonds were offered was too low; it enabled the buyers to resell them at a great advance, and thus to realize a profit which ought to have gone into the treasury of the company." That the stockholders did make a large profit when they resold the bonds is unquestionable; but that the price at which they acquired them was too low, measured by the standards and conditions of the time, is not so certain. A 3 per cent. bond was then an untried experiment. The bonds of the old company, which were about to mature, bore interest at 6 and 7 per cent. and nobody could tell in advance what the market value of a low-rate security would prove to be. That the price at which the 3 per cent. bonds were offered to the stockholders was low enough to give them a chance of profit is true; but there was no intention of giving them an exorbitant profit. A market for bonds bearing as low an interest rate as 3 per cent. had to be created. Such securities would naturally be taken by savings banks; but the bill making the 3 per cent. bonds of the Chicago & Alton company a legal investment for the savings banks of New York had not then passed the legislature, and it was

uncertain whether it would pass. If it did not, the demand for such bonds would be comparatively limited and they might not bring more than 70, at which price they would yield 4.28 per cent. The bill which authorized savings banks to invest in them did not become law until February 26, 1900, more than a year after the syndicate bought the road. It was then signed by Theodore Roosevelt, governor of the state, who apparently thought that the bonds of the "looted," "wrecked," and "gutted" corporation were a safe investment for savings banks.

In 1907, when the Interstate Commerce Commission investigated the subject, these very bonds were selling for only a little more than the price at which they were issued, although they were just as good then as they ever had been. The exceptionally high prices from which the stockholders profited, or may have profited, in 1901-1902, were purely fortuitous, and were due mainly to the state of the money market, the low rates of interest which then prevailed, and the unprecedented demand for investment securities.

It must not be forgotten, moreover, that in investing cash to the amount of $20,792,200 in 3 per cent. bonds, the stockholders took all

the chances of interest rates, state legislation, and savings bank demand, and that such chances might have gone against them. In that case, their bonds might have been unsalable and they might not have been able to get their money back. They took risks and reaped profits, and there was little if any criticism of their action until seven years later, when the Government, through the Interstate Commerce Commission, began its campaign against that "undesirable citizen," E. H. Harriman.

So far as this particular transaction is concerned, the federal authorities might, with equal reason, have begun proceedings against other railroad companies. In April, 1899, the Chicago, Burlington & Quincy sold to its stockholders at 75 three-and-one-half-per cent. bonds which went soon afterward above par, and some years earlier the St. Paul, Minneapolis & Manitoba sold to its shareholders at 10 an issue of mortgage bonds which later went above 100. It was at that time a frequently employed and never contested practice to give "rights" to stockholders by offering to them stocks or bonds at prices below their actual or possible market value, and it is still a common practice in other fields of business enterprise.

3. *The alleged over-capitalization.*

THE CHICAGO AND ALTON CASE

The question whether the Chicago & Alton Railroad was over-capitalized or not—that is, whether its capital stock exceeded its value—depends upon the definition given to the word "value." What is the "value" of a railroad? To this question three different answers have been given, namely:

(*a*) The value of a railroad is to be measured by the amount of money actually invested in it, from first to last.

(*b*) The value of a railroad is the present cost of building and equipping it, as new.

(*c*) The value of a railroad is the sum on which, as a "going concern," it can earn at least the current rate of interest.

The Interstate Commerce Commission seems to prefer the first of these definitions; some economists favor the second; while most railroad men adopt the third.

There seems to be no good reason for assuming that the value of a railroad differs in any essential way from the value of a farm or a factory. The value of a farm is to be ascertained by capitalizing its annual net return at the current rate of interest. Two farms may contain exactly the same number of acres, and may represent precisely the same original investment, and yet one may have twice the

value of the other. If a farm, during a series of years, shows its ability to earn, say, 6 per cent. upon a capital of $10,000, then the value of that farm is $10,000 no matter what its original cost was. The owner may have bought it for $5,000, but it would be manifestly absurd to say that its value is only $5,000 when it yields crops large enough to pay the current rate of interest on $10,000. Its value is to be measured not by the amount of money originally invested in it, but by its earning capacity as a "going concern." The same is true of a factory.

There was once a horseshoe nail manufactory in northern New York which was started with a capital of $100,000. By managing skilfully, and by gradually putting $400,000 of earnings into new plant, improved machinery, money-saving inventions, etc., the owners finally made it earn $300,000 a year, or 6 per cent. on $5,000,000. Was the value of that concern the $500,000 actually invested in it, or the $5,000,000 on which it could earn 6 per cent. a year?

In June, 1915, the directors of the Ford Motor Car Company of Detroit increased the capital stock of that corporation from $2,000,000 to $100,000,000. Forty-eight millions were distributed in the shape of a stock dividend,

and the remaining stock was held in reserve "for future dividends and the development of the company."[1] At the time of the increase of capitalization the actual assets of the company were $61,000,000 of which only $24,191,000 represented physical plant. Suppose that in future the company is able to earn 6 per cent. on its inflated capitalization of $100,000,000. What, then, will be the value of the manufactory? Will it be worth $2,000,000 (the amount of its original capital stock), or $24,191,000 (the amount actually invested in plant), or $61,000,000 (the amount of its total assets), or $100,000,000 (the amount on which it can earn 6 per cent.)? In explaining the transaction, James Couzens, Vice-President of the company, said: "The purpose of the increase in our capital stock is to have the outstanding stock more nearly represent the value of the company" —meaning, of course, its value as a "going concern." If it could earn, with regularity and safety, 6 per cent. on its expanded capitalization of $100,000,000 then its value would be $100,000,000 regardless of the fact that its original capital was only $2,000,000 and regardless also of the fact that its total assets fell nearly $40,000,000 short of its expanded capital.

[1]New York *Times* and New York *Sun*, June 5 and 20, 1915.

If the same reasoning is not applicable to the value of a railroad—why not? So far as the definition of "value" is concerned, no distinction can reasonably be made between a railroad and a manufactory. Both are to be valued according to their earning capacity. Upon this point political economists generally are agreed. Prof. H. R. Seager says:

"As an investment, land is valued, as is any other form of income-producing property, by capitalizing its annual return at the current rate of interest. For example, if a given piece of land is found by experience to bring in, on an average, a net rent of $1,200, and the current rate of interest is 6 per cent. its price will normally be $20,000 or the sum which invested at 6 per cent. will yield the same return."[1]

In considering the value of a railroad as it affects the security of its bondholders, Thomas L. Greene, Vice-President of the Audit Company of New York, says:

"The whole property of a railroad company, considered simply as real estate and old material, is worth but a small fraction of the amount for which it is mortgaged. The creditors of the company depend for their money not upon

[1] "Principles of Economics," by H. R. Seager, Professor of Political Economy in Columbia University; p. 239.

the property considered as such, but upon the business for which the company was organized; that is, upon the transportation of passengers and goods. If the earning capacity of that company becomes for any reason impaired, the strong legal language of the mortgage will not save the holder of the company's bonds from loss. In the end he must accept, as a basis for the revaluation of his securities, the earning power of the company as a carrier of traffic."[1]

This whole question of value, as it affects railroads, was discussed by Henry Fink, President of the Norfolk & Western Railroad Company, in a letter that he wrote to the Railroad Securities Commission in 1910, in reply to their request for information and opinions. His conclusion was that "the value of a railroad can be measured only by its earning capacity." His judgments, he added, were based on his own experience during sixty years of continuous railroad service.[2]

This view of railroad "value" has not only been accepted by the best economists and the most experienced railway administrators, but has repeatedly been sanctioned by the courts.

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[1] "Corporation Finance," by Thomas L. Greene, Vice-President of the Audit Company of New York; pp. 35-6 and 38. N. Y., 1913.

[2] "Federal Regulation of Railroad Securities and Valuation of Railroad Properties," by Henry Fink. Roanoke, Va., 1910.

In the Oklahoma case, Judge Hook said: "An established railroad system may be worth more than its original cost, and more than the mere cost of its physical reproduction." It has no value except as a going concern.[1]

This also was the view taken by the U. S. Supreme Court in the tax case of the C. C. C. & St. L. R. R. Co. vs. Backus. In its opinion in that case the court said:

"The value of property results from the use to which it is put, and varies with the profitableness of that use, present and prospective, actual and anticipated. There is no pecuniary value outside of that which results from such use. . . . Never was it held that the cost of a thing is the test of its value. Suppose there be two bridges over the Ohio, the cost of construction of each being the same, one between Cincinnati and Newport, and the other twenty miles below where there is nothing but a village on either shore. The value of the one will, manifestly, be greater than that of the other, and that excess of value will spring solely from the larger use of the one than of the other."[2]

Assuming then—or, rather, adopting the view of competent authorities—that the value

[1] "Railway Statistics of the U. S.," by Slason Thompson, p. 740. Chicago, 1914.

[2] 154 U. S. 445.

of a railroad, and consequently its proper capitalization, should be based on earning capacity, "present and prospective, actual and anticipated," was Mr. Harriman justified in believing that he could make the Chicago & Alton pay interest and dividends on a capitalization of $101,000,000?[1]

The annual net income needed would be $3,533,440, as follows:

Interest on $40,000,000	3 per cent. bonds .	$1,200,000
Interest on 22,000,000	3½ per cent. bonds.	770,000
Dividend on 19,544,000	preferred stock at 4 per cent. .	781,760
Dividend on 19,542,000	common stock at 4 per cent. .	781,680
$101,086,000		$3,533,440

Was it prudent and reasonable to anticipate that when the proposed betterments should be made, and the necessary equipment procured, the greatly improved road would be able to

[1]Owing to the necessity of spending for betterments four times as much as President Felton estimated, the capital stock was later increased (upon the figuring of the Interstate Commerce Commission) to about $114,000,000, but I am dealing here only with the original capitalization of $101,000,000 upon which Mr. Harriman's calculations were based.

earn the annual net income of $3,533,440, which would be required?[1]

In the year when the syndicate bought the Chicago & Alton, the road, even in its run-down and half-equipped condition, earned $2,684,694 net, and it had earned, on an average, $2,734,534 net, for the six preceding years (1893 to 1898, both inclusive). It was only necessary, therefore, that annual net earnings should be increased by $798,906 in order to pay interest and dividends on all outstanding securities. Mr. Felton, a thoroughly competent judge, estimated that by an expenditure of $5,200,000 in betterments the annual net earnings of the road might be increased at least $1,000,000. Mr. Harriman, an even better judge, believed that physical improvements and good management would bring the annual net

[1]So far as fixed charges are concerned, the capitalization of the Chicago & Alton would seem to have been prudent and conservative. According to Prof. Stuart Daggett, the average percentage of fixed charges to net income, in seven railroad reorganizations between the years 1893 and 1898 (the Atchison, B. &. O., Erie, Nor. Pac, Reading, Southern, and Un-Pac.) was 73.9. ("Railroad Reorganization," p. 358.) In the Chicago & Alton, after reorganization, this percentage was only 72, and before 1907 it had fallen below 60.

Prof. E. S. Mead says: "In most cases, no more than 20 per cent. of the gross earnings of a railroad company should be represented by interest charges." ("Corporation Finance," p. 65.) After the recapitalization of the Chicago & Alton, in 1900, the ratio of interest charges to gross earnings was 27.5; but in 1907, on the whole indebtedness then outstanding, it had fallen below 20.

earnings up to $4,000,000. How prudent and conservative these estimates were the result showed. In the year when the Interstate Commerce Commission investigated the recapitalization, the net earnings of the road were $4,415,974, a sum which was $415,974 above Mr. Harriman's estimate, and $681,440 above the estimate of Mr. Felton. If rates had not been reduced during the period of Mr. Harriman's administration, the increase in net earnings would have been even greater than this.[1]

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[1]The reduction of ton-mile freight rates between 1899 and 1907 is given by the Director of the Bureau of Railway Statistics as follows:

Year	Receipts per ton-mile (in cents)
1899	.800
1900	.796
1901	.723
1902	.679
1903	.599
1904	.677
1905	.689
1906	.639
1907	.604

A part of this reduction, but according to Mr. Thompson only a small part, was due to the development of a large coal traffic, on which the rates were low; but in commenting on the figures the Director says:

"Whatever may be the popular impression as to the overcapitalization of the Alton, the above table furnishes proof that it had no effect whatever in causing exorbitant rates, for these are nearly 25 per cent. lower than in 1899." ("Cost, Capitalization and Estimated Value of American Railways," by Slason Thompson, Director of Bureau of Railway Statistics, pp. 186-187. Chicago, 1907.)

A MISUNDERSTOOD TRANSACTION

A case parallel in some respects to that of the Chicago & Alton is furnished by the reorganization of the Norfolk & Western Railroad in 1896. In 1895, before the reorganization and recapitalization, the road and equipment were valued at $115,098,721 and the capitalization was $117,364,909 as follows:

Bonds	$ 57,864,909
Preferred stock	50,000,000
Common stock	9,500,000
Total capitalization	$117,364,909

In the reorganization, the bonds were increased by $4,635,000 and the common and preferred stock by $30,000,000, making an expanded capitalization of $151,999,909.[1] In commenting upon this inflation, which amounted as above shown to nearly $35,000,000, President Fink said: "Stocks issued in such cases are in no sense fictitious. They represent actual values, and are drafts, for value received, on more prosperous times."

He then shows that although the Norfolk & Western was over-capitalized in 1896, in the sense that it was not then earning dividends and fixed charges, it did begin paying dividends on its preferred stock in 1897, and on its common

[1] *Commercial and Financial Chronicle*, Vol. LXII, 1896.

in 1901.[1] Its stock is now quoted at 119, which shows that its earning power has much more than overtaken its expanded capitalization.

Mr. Harriman expected to do with the Chicago & Alton just what Mr. Fink did with the Norfolk & Western, viz., increase by means of extensive betterments its capacity for doing business and its earning power, and thus bring its net operating revenue up to the requirements of its enlarged capitalization. That he measurably succeeded in doing this is shown by the fact that when, after losing control of the road in 1903, he completely severed his connection with it in 1907, it was paying 4 per cent. on its preferred stock and earning 5 per cent. on its common. In other words, it was taking care of its entire capitalization, and was doing this with no increase of rates and with an enormous extension of its facilities for doing business and serving the public.

All these facts, however, were suppressed or ignored in the Interstate Commerce Commission's report. The Commissioners, from their point of view, might have been justified in expressing disapproval of Mr. Harriman's financial methods; but they were not justified in con-

[1] "Over-capitalization," by Henry Fink; *Railway Age Gazette*, July, 1908.

cealing the fact that these methods had more than doubled the capacity of the road to serve the people. "Suppressio veri suggestio falsi," and the concealment in this case gave the impression that Mr. Harriman—in the words of Senator Cullom—had "looted the road," regardless of the interests of the people and the territory that it served. The rebuilding of the Chicago & Alton was one of the great railroad achievements of the time; but in the report of the Commission it is made to appear a piratical raid of unscrupulous financiers, who, for their own selfish purposes, wrecked and looted a well-conducted and prosperous corporation. If the members of the Commission could be put on the witness stand, as Mr. Harriman was, and could be required, under oath, to tell "the *whole* truth," they might find it difficult to explain why, in a report that was supposed to cover all the facts essential to an understanding of the case, they said nothing with regard to the physical condition of the Alton road when the syndicate bought it; nothing about the intention of the old managers to declare just such a dividend as that declared later by the new managers; nothing about the sanction given by courts and legal authorities to the capitalization of past betterments; nothing

about the practice of the time in the matter of reorganizations; nothing about Mr. Harriman's virtual reconstruction and reëquipment of the road; nothing about the increase of 90 per cent. in gross earnings and 80 per cent. in net earnings which resulted therefrom; nothing about the benefit that the public derived from the lowering of rates and the improvement of facilities; nothing about the relation between the earning capacity of the reorganized road and its expanded capitalization; and nothing about the resumption of dividends on the preferred stock in 1906. A report which conceals or ignores these pertinent facts is not a judicial review of the case, but merely a prosecuting attorney's brief.

The responsibility for the present condition of the Chicago & Alton cannot justly be thrown upon Mr. Harriman. The control of the road was wrested from him by the Rock Island, while he was in Europe in 1903, and he severed his relation with it altogether when the Rock Island transferred its holdings to the Toledo, St. Louis & Western in 1907. The financial measures adopted by the later management were ill-advised and unfortunate, and never would have met Mr. Harriman's approval. Partly to these measures, and partly to regula-

tion, low rates, and depressed business conditions, the present difficulties of the road are due. When Mr. Harriman resigned, it was not only paying its fixed charges, but was earning more than 4 per cent. on both classes of its stock.

Before concluding this review of the Chicago & Alton reorganization, it seems necessary to answer specifically certain charges made against Mr. Harriman by two men who occupy positions of responsibility or authority, namely: Interstate Commerce Commissioner Prouty and Prof. William Z. Ripley of Harvard University.

In an address delivered before the National Association of Manufacturers, in May, 1907, Commissioner Prouty said:

"When Mr. Harriman, by dealings like those in the Chicago & Alton, enriches himself to the extent of many millions, he has not created that money. He has merely transferred it from the possession of some one else to himself."[1]

In the first place, there is no evidence to show that Mr. Harriman, as an individual participant in a syndicate of one hundred members, enriched himself to the extent of "many millions." In the second place, it may controversially be said that when the Interstate Commerce Com-

[1]New York *Independent*, May 30, 1907, p. 1129.

missioners, by drawing money in the shape of salaries from the people of the United States, enrich themselves to the extent of many hundreds of thousands of dollars, they have not created that money. They have merely transferred it from the possession of some one else to themselves. They may reply that for the money they have thus transferred from the people of the United States to themselves, through the United States Treasury, they have rendered valuable services—in other words, they have earned it. Mr. Harriman might have said the same, and with much more reason. By his "dealings" in the Chicago & Alton he almost entirely rebuilt the road; doubled its passenger accommodations; improved immensely its train service; increased by 134 per cent. the hauling power of its locomotives; added 269 per cent. to its capacity for moving freight; fostered old industries and created new ones all along its line, and enabled the people of Illinois to "create" tens of millions of dollars which they never could have created without the traffic facilities given them by Mr. Harriman's betterments. If the Interstate Commerce Commissioners could show anything like this equivalent for the money they have "transferred" from the United States Treasury to

themselves, their claim to have earned their salaries would be unquestioned and unquestionable. Unfortunately, in the judgment of many thinking people, they have injured the business of the country instead of promoting it, and by their cramping over-regulation of railroads have frightened away capital, and have thus prevented the construction of thousands of miles of new road, which the country already needs, and will need still more urgently in the near future. In the judgment of many competent observers they have also forced into bankruptcy dozens of railroads which were not mismanaged, and which might have met all their obligations if they had been allowed to make their rates high enough to cover increased taxes, increased wages, and the largely increased cost of materials and equipment. Eighty-two railway corporations are now in the hands of receivers, and even Mr. Prouty will hardly contend that they have all been "wrecked," "looted," or financially mismanaged by unscrupulous speculators. Most of them have failed simply because the policy of the Interstate Commerce Commission has impaired the credit of railway corporations generally, and made it impossible for weak roads to sell their securities on advantageous terms. Investors

will not buy such securities until they have a reasonable assurance that the Commission will permit the companies to earn fixed charges and dividends. It seems, therefore, to be at least a debatable question whether the Commission has not wrecked more railroads than the unscrupulous financiers have.

One of the most unfair, as well as one of the most recent, of Mr. Harriman's assailants is Prof. William Z. Ripley, Ropes Professor of Economics in Harvard University. In a volume entitled "Railroads: Finance and Organization," published by Longmans Green & Co. of N. Y., in 1915, Professor Ripley devotes a large part of his eighth chapter to the Chicago & Alton reorganization, and begins his account of it in the following words:

"Practically all of the possible abuses and frauds described in the preceding pages under the caption of stock-watering are found combined in a single instance in recent years—the reorganization of the Chicago & Alton road by the late E. H. Harriman and his associates during the eight years following 1898."[1]

Most of the hostile critics of the Chicago & Alton transaction try to make their points by

[1]Chapter VIII, p. 262.

concealing or ignoring facts favorable to the defence. Professor Ripley not only conceals or ignores, but misstates. He says, for example, that the Chicago & Alton road, prior to the reorganization, was doing "a constantly expanding business." This, simply, is not true. The gross earnings of the road had decreased more than $2,500,000 in the eleven years that preceded the change of ownership. In 1887 they were nearly $9,000,000, while in 1898, the year before the Harriman syndicate acquired the property, they had fallen to $6,286,568. A business which declines to the extent of $2,655,000 in a little more than a decade may still continue to be a profitable business, but it certainly is not "a constantly expanding business."[1]

[1]Prof. E. S. Mead, who is a much more careful and trustworthy student of railroad affairs than Professor Ripley seems to be, states the fact accurately when he says ("Corporation Finance," p. 251): "The earnings of the Chicago & Alton, prior to the reorganization, had been stationary for many years." They had been stationary for about five years, but had decreased 30 per cent. in eleven years. The precise figures are given by Director Thompson of the Bureau of Railway Statistics as follows:

Year	Gross earnings
1887	$8,941,386
1888	7,511,465
1889	7,516,616
1890	7,065,753
1891	7,590,881
1892	7,730,610
1893	7,566,640
1894	6,292,236

THE CHICAGO AND ALTON CASE

Professor Ripley states repeatedly (pp. 264-265) that the operations of Mr. Harriman and the syndicate were "covered up," "remained undisclosed," "were never disclosed," "were obscured in the published accounts," and "were thoroughly concealed." This, again, is simply not true. All the operations of Mr. Harriman and the syndicate, including the capitalization of past betterments, the declaration of a 30 per cent. dividend, and the sale of the 3 per cent. bonds to the stockholders at 65, were fully and accurately set forth in the listing application to the New York Stock Exchange, as well as in the leading railroad and financial publications of New York, including *Poor's Manual*, *Moody's Manual*, the *Manual of Statistics*, the *Commercial and Financial Chronicle*, the *Wall Street Journal*, and the New York *Evening Post*.[1]

1895	$6,292,486
1896	6,840,283
1897	6,673,605
1898	6,286,568

("Cost, Capitalization, and Estimated Value of American Railways," by Slason Thompson, Director of the Bureau of Railway Statistics; p. 183. Chicago, 1907.)

[1] *Poor's Manual* for 1900, pp. 654 and 657, and for 1901, pp. 661-2. *Moody's Manual* for 1901, p. 1195. *Manual of Statistics* for 1900, p. 61, and for 1901, p. 59. *Commercial and Financial Chronicle* in the five numbers for April 7 and 14; May 5 and 19; and November 17, 1900.

In commenting upon this feature of the case, in a statement written in 1907 but never published, Mr. Harriman said:

"Every essential fact connected with the recapitalization of the Chicago & Alton system, including the objects for which the new securities were issued, was fully disclosed and widely published, at the time, in circulars, financial papers, annuals, and reference books for investors, etc., etc. These publications, as well as the printed applications to the New York Stock Exchange, showed exactly for what consideration each class of securities had been issued, including the fact that the refunding 3 per cent. bonds of the railroad company had been subscribed for by the stockholders at 65, and that a dividend of 30 per cent. had been declared in May, 1900. The listing committee of the Exchange investigated fully, and unanimously recommended the granting of official quotations to all the securities and their admission to dealings on the Exchange. This recommendation was approved, without any dissenting voice, by the Board of Governors of the Exchange, consisting of forty members of high standing. So far as I know, there has never been the slightest pretence that any of the original stockholders were deceived in any manner or form, or that any subsequent investor was in any way misled. All parties in interest have acquiesced, for seven years, with

full knowledge. The transaction is now criticised, for the first time, and in a manner calculated to misrepresent and distort the facts as they existed in 1900 when the securities were created and issued."

Mr. Harriman's statement, supported though it be by all the railroad manuals and financial journals of New York, may fail to carry conviction to as biassed a mind as that of Professor Ripley; but it will be generally accepted by people who are more desirous of knowing the truth than of making out a case against the Chicago & Alton syndicate.

Professor Ripley accuses Mr. Harriman of "prejudicing the interest of shippers by creating the need of high rates for service in order to support the fraudulent capitalization." (p. 262.) This charge is doubly misleading. In the first place, it erroneously assumes that rates are dependent upon capitalization, and in the second, it suggests that, as a matter of fact, Mr. Harriman did raise rates on the Alton in order to bolster up fictitious securities. Neither the assumption nor the suggestion is supported by the facts.

High capitalization, as a rule, does not result in high rates. On the contrary, the lowest average freight rates are in the parts of the

United States that have the highest railroad capitalization.[1] That there is no interdependence of capitalization and rates has been repeatedly admitted even by the Interstate Commerce Commission. As long ago as 1899 Chairman Martin A. Knapp testified before the Industrial Commission that he had never seen a case in which rates seemed to depend upon capitalization, or to be influenced by it. "The capitalization of a railroad," he said, "cuts no figure in this rate question."

In an article entitled "Railroad Capitalization and Federal Regulation," Franklin K. Lane, while he was yet Commissioner, said: "Fundamentally there is no interdependence of capitalization and rate. The latter is not in law, nor in railroad policy, the child of the former."

Mr. Harriman, who had a much clearer understanding of the principles of rate-making than the Harvard Professor of Economics seems to have, said in the unpublished statement previously quoted:

"It is just as impossible to raise rates to any level that may be necessary to pay charges on increased capitalization as it would be for a

[1] "The Railroad Situation of To-day," by Frank Trumbull: An Address to the Western Society of Engineers, January 5, 1909, p. 7.

manufacturer of steel, or of woolens, or of any other commodity, to raise his prices because he had a large debt upon which it was necessary to pay interest, or a large capital employed in the business. It would be suicidal for a railroad company to throttle or paralyze the industries along its lines by charging exorbitant rates. Even if there be no direct competition by parallel roads, every industrial plant located along a line of railroad is competing with plants located on other lines, and every railroad is forced to make such low and reasonable rates as will permit the industries in the territory tributary to it to make sales in competitive markets, and thus furnish the traffic from which the railroad company derives its earnings. It is impossible for a railroad company to sever its interests from those of its patrons. Its life blood is drawn from their prosperity, and it must furnish them with adequate and ever-increasing facilities at reasonable rates, wholly irrespective of its capitalization. If the calculations of the organizers of a railroad company turn out to be erroneous, and the capitalization is fixed at too high a figure, it is a misfortune for them and the other security holders; but the wide-spread popular impression that a railroad company can extort money from the public at will, and in defiance of the laws of trade, simply for the purpose of paying interest or dividends upon increased issues of securities, is not justified by the facts."

In this brief statement there is more financial and economic wisdom, perhaps, than in a dozen volumes of Interstate Commerce Commission reports, and more even than in some Supreme Court decisions.

The statement that the "unscrupulous management" of the Chicago & Alton did, as a matter of fact, "increase rates for service in order to support the fraudulent capitalization" is not true. The freight records of the Chicago & Alton for the period in question show a slight reduction in rates on grain, live-stock, merchandise, and other classified commodities, with a very substantial reduction on coal. In 1899 the through rate on coal from the Springfield district was 80 cents. In 1907 it fell as low as 40 cents. The average rate per ton per mile on the whole traffic (including coal) was reduced, as Slason Thompson has shown, about 25 per cent. The precise figures have been given on a previous page.

The most surprising of all Professor Ripley's misstatements is that which charges Mr. Harriman with "crippling" the Alton road "physically." (p. 262.) Mr. Frank H. Spearman, who made the rebuilding of the Chicago & Alton the subject of a special article, described the "crippling" process in the following words:

"Without delay or hesitation he"—(Mr. Harriman)—"set about making of the Alton the best possible road of its class, and its class is the first. He overhauled the system completely, and put it physically a little in advance of every competitor. To instance: For thirty years the Alton had been strong in a territory possessing the richest coal deposits in Illinois, and not until the Harriman forces took hold of the road had it ever developed a coal business. Not only has the new Alton been equipped with what it never had before, cars and motive power to handle this traffic, but its engineers, in rebuilding the line, show the lowest maximum grades from the Illinois coal fields into Chicago. Beginning with nothing, the new owners have, within five years, developed a coal traffic that already ranks second in volume among the soft-coal roads of its territory. . . . The Alton being once acquired, it became the policy of the new owners to increase the facilities of the public along their line for doing business. . . . The heaviest freight engines previously owned had been of fifty-five tons, and were capable, in condition, of hauling thirty cars, of twenty-five tons each; but the engines had been allowed to deteriorate until not above 80 per cent. of that capacity could be obtained. The new engines, of the consolidation type, for freight traffic, weigh one hundred and sixty-five tons and haul one hundred freight cars. The passenger power consisted of forty- to fifty-ton

engines, capable of hauling five to seven coaches of their day at high speed. Such engines have been replaced by modern engines of one hundred and thirty-five tons, while for especially heavy passenger service, of which the road has more than any line in its territory, exceptionally large engines have been provided, recent additions including the two most powerful express passenger engines in the world. . . . In freight car equipment, twenty- and twenty-five-ton capacity wooden gondola cars were replaced by fifty-five-ton capacity steel gondolas, and the proportion of the weight of car to load was reduced one third at a stroke. Acquiring a line that had always enjoyed a heavy passenger traffic, the new owners, where they had found fifty-feet coaches, built coaches seventy feet long, and by ingeniously installing seats of a modern type, as well as more comfortable than those of earlier models, they have succeeded in accommodating in the new cars twice the number of passengers provided for in the old. . . .

"What it means to make over a railroad for such modern traffic requirements is reflected sharply in the work put upon the construction department. Working out of Chicago, track elevation was pushed until every railroad grade-crossing, from the terminal station to the suburban yards, has been eliminated. The grades receiving the heaviest of the traffic, as it centred toward Chicago, were reduced until they gave the rebuilt road the lowest maximum grade of

any road entering Chicago from the western coal fields. At the very outset the work of double-tracking was begun. To provide for heavy cars and engines, heavier rails have been spread south and west until to-day over one half the total mileage of the entire system shows new steel. The work falling on the bridge department was continuous and exacting. While shops were being enlarged, engine-houses rebuilt, and turn-tables lengthened, the track elevation at Chicago called unceasingly for viaducts, and the traffic conditions everywhere on the system demanded new bridges for the motive power. . . . On less than a thousand miles of trackage three hundred and eighteen bridges were replaced within four years. Of these, one hundred and fourteen bridges were wholly done away with by the cast-iron pipe and the concrete arch—the progress in the use of concrete work being one of the most striking features of recent bridge construction. But besides the great bridge across the Missouri" —(the old million-dollar steel bridge was "scrapped")—"and four solid-floor creosoted trestles, one hundred and twenty-two steel bridges also were installed.

"The elimination of curvature, pushed till the maximum had been reduced to four degrees, is still in progress, and so far has bad curvature been taken care of that an engineman familiar with a division five years ago would hardly recognize the right of way in the daylight.

Long restful stretches of straight track have been developed until there are now on the system many tangents of from fifteen to twenty miles; there is at least one tangent of twenty-nine miles; and one extraordinary stretch of forty-five miles of track, straight as an arrow's flight. . . . To strengthen the work of the operating department, the railroad world has been drawn upon for the most effective safety devices in the operation of trains. Long stretches of track, in one instance covering a distance of sixty-five miles, are provided with continuous electric signals which protect moving trains, stations, grades, and curves. Previously to the rebuilding there were comparatively few interlocking signals on the whole line to protect railroad grade-crossings."[1]

According to Professor Ripley, the nefarious purpose of the "main conspirator" in making all these improvements was to "cripple" the road "physically!"

During the period of Mr. Harriman's administration he spent $11,262,763 on roadway and structures, and $11,064,454 on new equipment, making a total of $22,327,219 for permanent betterments, a sum equivalent to about $22,000 per mile. The road thus "physically

[1] "The Rebuilding of an American Railroad," by Frank H. Spearman (in "The Strategy of Great Railroads"), pp. 50, 223, 225-226. N. Y., 1914. This article was originally published before the work of rebuilding had been finished.

crippled" increased its gross earnings from $6,286,569 in 1898 to $12,809,426 in 1907, and its net earnings from $2,684,694 to $4,415,974. How it was able to do this, in its "physically crippled" condition, Professor Ripley does not explain.

Those who have made a serious study of Mr. Harriman's activities know that he never "physically crippled" a railroad in his life. On the contrary, he never touched a railroad that he did not physically improve. From the Sodus Bay & Southern to the Union Pacific and the Alton, he made every railroad that he controlled serve the public better than it had ever served it before. No railroad corporation, moreover, ever defaulted on its bonds, or failed to earn its fixed charges, under Mr. Harriman's management.[1]

It is not easy to characterize Professor Ripley's statements fittingly without overstepping the bounds of controversial courtesy; but inasmuch as he, himself, has not hesitated to call Mr. Harriman a "conspirator," and to describe his management of the Chicago & Alton as "unscrupulous," "piratical," "fraudulent," and "predatory," it may perhaps be proper to say,

[1]Hearings before the Interstate Commerce Commission in the Chicago & Alton Case, p. 73.

in the form, although not quite in the words, of the professor's opening sentence:

"Practically all of the possible methods, described in previous pages, of making a thing seem that which it is not, are found combined in a single instance in recent years—the account of the reorganization of the Chicago & Alton Railroad by William Z. Ripley, Ropes Professor of Economics in Harvard University."

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